

ECONOMICS: AUSTRALASIAN PERSPECTIVES—AUGUST 10, 2010

Is the Australian Consumer Spending Slowdown an Illusion?

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Recent data suggest that Australian consumer spending may be weakening. However, we believe income trends, tax cuts, buoyant confidence, and a pause in central bank rate hikes support firm spending through the second half of 2010 and into 2011.

Australian retail sales figures over the past couple of months have surprised to the downside, rising by just 0.2% in each of May and June. The year-on-year growth rate has slipped back to the 1%–2% range from the 7%–8% recorded through 2009. It's certainly the case that a rising debt servicing burden is starting to bite as the Reserve Bank of Australia (RBA) hikes rates **(Display 1)**. But are the latest data signaling a more fundamental weakening of the Aussie consumer? We think not—or at least not yet—for a number of reasons.

Technical Factors Skew Data

First, the slowdown is partly illusory. There were significant fiscal handouts to consumers in late 2008 and the first half of 2009. Not surprisingly, this provided a big boost to retail spending volumes in the first and second quarters of 2009 **(Display 2)**.

Year-on-year comparisons are still challenging because of that base effect. Less well recognized is the fact that a proportion of the stimulus spilled over into

higher prices in late 2008 and early 2009, again pushing the base up, and providing some constraint on retail price growth over subsequent quarters. Hence it should not have been surprising to see a marked deceleration in nominal retail spending over the past year. Those base effects have now largely run their course, and should not be a big influence from here on.

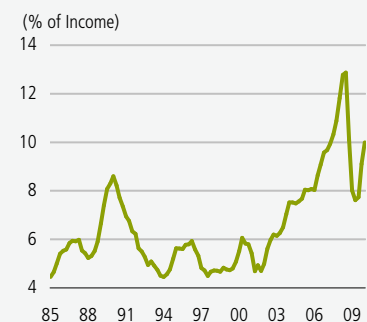
Income Generation Remains Robust

Fundamentals of income generation remain positive. Recent trends in employment growth have been stellar. The number of jobs has risen by more than 350,000 over the last 12 months (that is, a pace exceeding 3%). The breadth of the recovery has improved, too, with full-time jobs growth outpacing part-time over the past six months, and the number of average hours worked rising.

Leading indicators suggest solid employment growth will continue in the months ahead. With average weekly earnings now growing at more than 5%, underlying labor income growth is pushing 9%—

Display 1
Debt Servicing Burden Is Rising

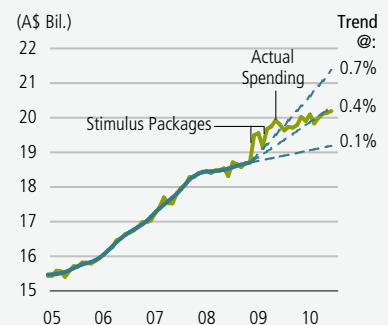
Interest Payments as a % of After-Tax Income



Source: Australian Bureau of Statistics

Display 2
Fiscal Boost Distorts Retail Sales Trend

Actual Retail Spending vs. "Trend" Scenarios



Source: Australian Bureau of Statistics and AllianceBernstein estimates

one of the highest readings in the past couple of decades (**Display 3**). Add the impact of the income tax cuts delivered at the start of July and it's hard to get pessimistic about underlying fundamentals.

Consumer Confidence Is Solid

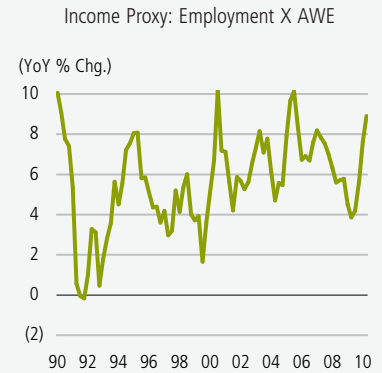
Consumer sentiment remains buoyant. After taking a hit earlier this year when the RBA was delivering back-to-back rate hikes, consumer sentiment has bounced back strongly. At 113.7, the latest reading is once again close to all-time highs (**Display 4**). This is not really consistent with a household sector under stress: declining unemployment and the 20%-plus rise in house prices seem to

have offset any worries about rising interest rates.

Spending Outlook Looks Promising

The combination of solid income fundamentals, tax cuts, buoyant confidence, an RBA on hold (for now) and technical factors bolster our expectations of surprisingly firm consumption spending readings through the second half of 2010 and into 2011. With other areas of private spending also likely to be strong, this underpins our view that domestic demand should run in the 4%–5% range over the next 12–18 months. In turn, this reinforces our bias towards rising rates, a flattening of the Australian government yield curve and a firm Australian dollar. ■

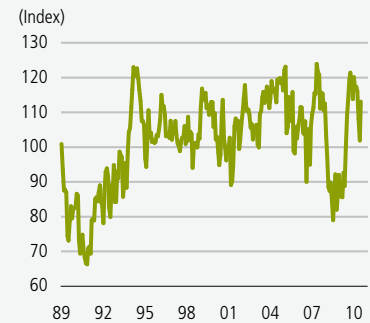
Display 3
Underlying Labor Income Growth Looks Very Strong



Source: Australian Bureau of Statistics

Display 4
Consumer Sentiment Bounces Back

Westpac/Melbourne Institute Consumer Sentiment Index



Source: Westpac/Melbourne Institute

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